IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF COLORADO

HONORABLE CHARLES E. MATHESON

In re:	)
	)
COTTRELL INTERNATIONAL, LLC	) Case No. 00-13592 CEM
EIN: 84-1459735	) Chapter 11
	)
Debtor.	)

ORDER ON MOTION TO PAY POSTPETITION RETAINER

The Debtor in this Chapter 11 case has filed an application to employ legal counsel and to pay the law firm a retainer of $40,000. The retainer is to be paid postpetition at the rate of $10,000 a month. Counsel will be allowed to draw on the retainer to pay interim fees and expenses, as allowed by the Court after notice and a hearing. Notice of the proposed arrangement was given to all interested parties, and no one filed an objection except the office of the United States Trustee. That objection has been resolved by stipulation.[1]

The Court set the matter for hearing. The question posed was whether the payment of a postpetition retainer could properly be allowed. In particular, concern was expressed whether the payment of such a retainer would elevate the attorneys to an administrative priority that is not otherwise accorded under section 503(b)(3) and 507(a)(1) of the Code. This concern has arisen because of the holding of the court in ***In re Printcrafters, Inc.,*** 233 B.R. 113 (D. Colo. 1999). In ***Printcrafters*** the court held that an attorney who had been employed pursuant to an order issued under section 327 of the Code and who, as a condition of employment, had been paid prepetition a retainer, could draw against the retainer for the payment of fees allowed for services during the debtor's Chapter 11 case, even though the case had been converted to Chapter 7 and there were not sufficient funds in the estate to pay all Chapter 7 administrative claims. The Chapter 7 trustee had sought to surcharge counsel and to have the retainer disgorged in order to provide funds to pay the Chapter 7 expenses. The district court held that the bankruptcy court's order of disgorgement was improper, that the attorney (because of the order authorizing the retainer in the first instance) held a valid and perfected lien on the retainer to secure the payment of allowed fees, and that he was entitled to retain the funds notwithstanding the fact that other administrative claims would go unpaid.

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[1] The stipulation with the Trustee also provides that the installment payments on the retainer are not to be made if the Debtor is not current in the payment of its other postpetition expense obligations.

Prior to ***Printcrafters***, the use of prepetition retainers for counsel in Chapter 11 cases was, if not common, at least not unusual and was usually approved, as it had been by the bankruptcy court in ***Printcrafters.*** However, it was the general belief of the judges of this Court that the retainer did not serve to elevate the administrative priority of the claims of an attorney for allowed fees and that, if it happened that ultimately the estate proved to be administratively insolvent, the attorney might be required to disgorge some or all of the retainer or the funds withdrawn by counsel from the retainer for the payment of allowed fees. ***Printcrafters*** established that this general belief was in error.

So long as the retainers paid to attorneys were considered to be subject to disgorgement, the concern over the practice of taking retainers was minimized. There were, to be sure, instances of apparent overreaching by an attorney. And, it must be observed, there were times when it appeared that the taking of the retainer by an aggressive attorney served to strip the prospective debtor of the very cash funds that were essential to the success of the Chapter 11 case. But these were the exception. Potential disgorgement also acted as a buffer for other administrative claimants, such as counsel for the creditors' committee, who arrive later in the case and after debtor's counsel has already extracted the cash available. ***Printcrafters*** has served to upset this balance.

What is now before the Court is the question of whether the attorneys should be permitted to receive from the debtor, postpetition, a retainer to be held by the attorneys to secure the payment of fees for services to be provided during the pendency of this Chapter 11 case. Counsel argues that the case should be guided by ***Printcrafters*** because there is no apparent reason why postpetition retainers should be treated any differently that prepetition retainers.

The Court agrees that the analysis should be the same for both pre- and postpetition retainers. In both instances it is agreed that the funds held by the attorney at the time the court enters an order approving employment and the retainer, are property of the estate. ***In re Printcrafters,*** 223 B.R. at 119. Indeed, if there was ever any question in this regard it has since been settled by the Colorado Supreme Court which has explicitly held that an attorney has an ethical obligation to hold any retainer in the attorney's trust account and that the attorney is obligated to repay to the client any unearned portion of the retainer upon demand by the client. ***In the Matter of Larry D. Sather***, No. 99SA72, 2000 WL 655914 (Colo. May 22, 2000). In the bankruptcy context this means that if the court declines to approve the employment of an attorney who has received a prepetition retainer, the balance of the retainer must be turned over to the bankruptcy trustee for administration as an asset of the estate. But the Court does not agree that ***Princrafters*** is dispositive of the issues now before the Court because ***Printcrafters*** does not deal with the question of whether the retainer arrangement should have been approved in the first instance. The whole focus of ***Printcrafters*** is on the question of the effect of the order approving the retainer.

Counsel acknowledges that, if the retainer arrangement is approved by the Court, the attorney will have a lien on property of the estate to be held by the attorney as security for the

payment of fees. In ***Princrafters*** the court quotes with approval the decision of the First Circuit to the effect that an attorney who is retained to render professional services to a debtor-in-possession "becomes a creditor of the estate just as soon as any compensable time is spent on account." ***In re Printcrafters,*** 233 B.R. at 117, citing ***In re Martin***, 817 F.2d 175, 180 (1st Cir. 1987). In other words, by providing services the professional extends credit to the debtor, the repayment of which is to be secured by a lien on the funds advanced as a retainer.

The Code has explicit provisions dealing with how, and under what circumstances, a debtor-in-possession, acting as the "trustee" in a Chapter 11 case, can obtain credit. Section 364 of the Code allows the "trustee" to obtain credit on an unsecured basis or, in appropriate cases, on a secured basis, or on a super-priority basis. However, those provisions only pertain to credit that will constitute an administrative expense pursuant of 11 U.S.C. §503(b)(1). Administrative expenses for the fees of a professional are allowed under section 330 of the Code, and have an administrative priority provided for under section 503(b)(3).

Counsel for a debtor-in-possession in Chapter 11 must be approved by the Court pursuant to 11 U.S.C §327. Such employment may be approved "on any reasonable terms and conditions of employment, including on a retainer . . . ." 11 U.S.C. §328(a). This can include the payment of a postpetition retainer. ***In re Jefferson Business Center Associates,*** 135 B.R. 676, 680 (Bankr. D.Colo. 1992). Because section 328 explicitly provides for a retainer, and because section 364 is not applicable to extensions of credit for the payment of administrative expenses provided for under section 503(b)(3) of the Code, the Court concludes that the authority to allow the payment of retainers, both pre- and postpetition, and to set the terms therefor, must be inferred from and under section 328.

In acting on a request for the approval of a retainer, particularly one that is to have the effect realized in ***Printcrafters***, the Court must be mindful of the fact that the Code, in sections 503, 507 and 726, establishes an elaborate system of priorities for the payment of administrative expenses and claims. The establishment of a retainer on the terms recognized and enforced in ***Printcrafters*** has the effect of reordering that statutory priority and must, therefor, be approached with caution.

In the ***Jefferson Business*** case the court identified several factors that could properly be conisdered in evaluating the propriety of a postpetition retainer. The court recognized that having competent counsel is imperative to the success of a Chapter 11 case. The court could also consider (1) the economic impact the payment of the retainer might have on the debtor's business; (2) the retainer's impact on the prospects for reorganization (which, of necessity, must include an evaluation of whether the debtor will, at confirmation, have funds available to pay all administrative expenses as required by 1129(a)(9) of the Code); (3) the amount and the reasonableness of the retainer; (4) the reputation of counsel; and (5) the ability of counsel to be able to disgorge the retainer if, at the conclusion of the case, the court should determine that the fees paid during the case were not justified. In addition, it appears to this Court that it is appropriate to consider whether the retainer arrangement will have a chilling effect on the

adversary system by unduly restricting the availability of funds to pay other professionals in the case, including counsel for the creditors' committee, if any (***see, In re Ames Department Stores, Inc.,*** 115 B.R. 34, 38 (Bankr. S.D.N.Y. 1990)), and whether it is likely that there will be assets available to pay the Chapter 7 priority administration expenses, mandated by section 726(b) of the Code, in the event the Chapter 11 fails.

In the matter before the Court, the attorneys seek employment under section 327(e) of the Code. Their role will be to continue litigation instituted by them prepetition on behalf of the Debtor. The lawsuit involves claims against a former customer of the Debtor whose alleged wrongful conduct appears to have been a substantial contributing factor to the necessity for this Chapter 11 case. The stipulation with the U.S. Trustee goes far in reducing concerns that the retainer will be an undue burden on the Debtor's operations or will impose risks that other administrative claims may not be paid. Further, early hearings in this case indicate that there is a significant probability that this Debtor will be able to effectuate a successful plan of reorganization, that the likelihood of conversion to Chapter 7 is slight, and that there will in any event probably be adequate assets available to pay the expenses of the administration of the estate, both for the Chapter 11 and any ensuing Chapter 7. Given the size of the retainer, and the significant size of the estate, there is no apparent chilling effect on the adversary system.

Having considered the application and the factors enumerated, the Court concludes that it is appropriate to authorize the payment of the retainer as requested, and a separate order doing so, incorporating the terms of the stipulation with the Trustee, will enter. The retainer will stand as security for the payment of fees as allowed by the Court in this case, all as within the meaning and intent of the order in ***Printcrafters.*** There is this admonition, however. Section 328 makes clear that an order allowing employment on terms, such as the payment of a retainer, remains reviewable by the Court and may be modified (with the result of possible disgorgement) if the "terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions." 11 U.S.C. §328(a).

It is so ordered.

DATED:

BY THE COURT:

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Charles E. Matheson, Judge

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